

Alan Bollard: A financial system that works for New Zealand

Excerpt from an address by Dr Alan Bollard, Governor of the Reserve Bank of New Zealand, to the Financial Services Institute of Australasia, Wellington, 23 May 2006.

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"In our latest *Financial Stability Report (FSR)*, issued on 19 May, we assess that, over recent months, the New Zealand and global financial systems have continued to perform soundly. However, signs of increased volatility have emerged in some markets (eg, commodities and foreign exchange) and some major challenges to financial stability persist.

"The Reserve Bank's interest in financial stability and banking regulation is to ensure there is adequate identification, pricing, and allocation of risks to the New Zealand financial system.

"Many of the current challenges to New Zealand financial system stability were identified in our November *Report*, and some have increased. For example, New Zealand banks have continued to raise their exposure to the housing market. A very large proportion of foreign capital being utilised in New Zealand is now intermediated through the banking sector via secured residential mortgage lending. A slower housing market will thus pose challenges to bank risk management and we will continue to monitor this closely, especially when implementing the new bank Basel II capital requirements regime.

"In addition, some (but not all) finance companies raising funds from the public have accumulated large exposures to property and consumer finance. These institutions could be hardest hit by slowing spending; especially those that have recently experienced rapid growth and have limited experience in managing downturns.

"New Zealand households have also been increasingly ready to purchase property for investment purposes. Household indebtedness has increased significantly, so that over time households have raised their financial vulnerability to interest rate changes, unemployment, and swings in rental incomes and property capital values. On balance, the data suggest that the New Zealand household sector has continued to increase its financial concentration and overall debt exposure.

"A slower growing economy will bring challenges to some households, in particular lower and middle income households that have large debt-servicing needs.

"Meanwhile, New Zealand's financial markets have remained sound. The decline in the New Zealand dollar over the March quarter, from its previous exceptionally high level, represents some reduction in risks. The depreciation was managed in the foreign exchange market with good liquidity and efficient pricing, and was principally a cyclical adjustment to better reflect the underlying fundamentals of the economy.

"We have also been working with banks to ensure adequate access to liquidity for settlement purposes. Work on access and governance issues with regard to the payment system also continues, and we will continue to pursue more rapid progress in this area.

"Ownership of banks in New Zealand is dominated by overseas investors. Foreign ownership has brought many benefits, including scale and scope, to our banking system. However, it also has resulted in a banking system with concentrated ownership that is tightly tied to Australian financial stability. The Reserve Bank, therefore, attaches a high degree of importance to monitoring developments in Australia and to our relationship with the Australian regulator, APRA, and our work within the Trans-Tasman Banking Council set up last year.

"The two Governments have agreed to legislation to require the Reserve Bank and APRA to consider the effects of their own regulatory actions on financial system stability in the other country. A statutory manager or administrator would have to inform the local regulator if they felt that actions might be detrimental to financial system stability in the other country. Work is underway on these proposed trans-Tasman legal amendments. These changes should help Australian banks meet New Zealand outsourcing requirements.

"There is more work to do. Next, the Council proposes to focus on crisis management preparation. This will build on existing arrangements to enhance the ability to respond to a trans-Tasman banking distress situation.

"A foreign-owned bank will inevitably be focused on long-term returns to its (mainly foreign) shareholders. But New Zealand's liberal attitude to bank ownership should not be misconstrued as giving away our interest in the New Zealand financial system. Our focus is on regulation to ensure financial stability for New Zealanders."